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BEFORE THE ARIZONA CORPORATION COMMISSION

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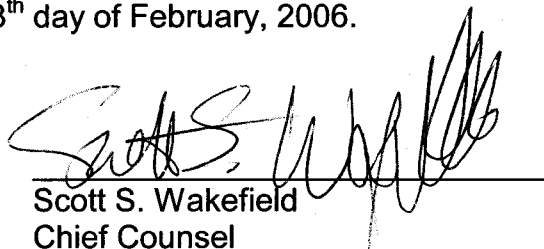
IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY  
FOR AN EMERGENCY INTERIM RATE  
INCREASE AND FOR AN INTERIM  
AMENDMENT TO DECISION NO. 67744

Docket No. E-01345A-06-0009

**NOTICE OF FILING**

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing  
the Direct Testimony of Marylee Diaz Cortez in the above-referenced matter.

RESPECTFULLY SUBMITTED this 28<sup>th</sup> day of February, 2006.

  
Scott S. Wakefield  
Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES  
of the foregoing filed this 28<sup>th</sup> day  
of February, 2006 with:

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Phoenix, Arizona 85007

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7  
8  
9  
10 By



Ernestine Gamble  
Secretary to Scott Wakefield

**ARIZONA PUBLIC SERVICE COMPANY**

**DOCKET NO. E-01345A-06-0009**

**DIRECT TESTIMONY**

**OF**

**MARYLEE DIAZ CORTEZ, CPA**

**ON BEHALF OF**

**THE**

**RESIDENTIAL UTILITY CONSUMER OFFICE**

**February 28, 2006**

**INTRODUCTION**

Q. Please state your name, occupation, and business address.

A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant. I am the Chief of Accounting and Rates for the Residential Utility Consumer Office (RUCO) located at 1110 W. Washington, Suite 220, Phoenix, Arizona 85007.

Q. Please state your educational background and qualifications in the field of utility regulation.

A. Appendix I, which is attached to this testimony, describes my educational background and includes a list of the rate case and regulatory matters in which I have participated.

Q. Please state the purpose of your testimony.

A. The purpose of my testimony is to respond to Arizona Public Service Company's (APS or Company) request for an emergency interim rate increase and provide RUCO's recommendations.

**APS' Emergency Interim Rate Request**

Q. Why is APS requesting an emergency rate increase?

A. APS' fuel and purchased power costs have significantly increased such that APS wants to increase its base rates to include the current cost of these commodities. The Company estimates a \$299 million increase is

1 required to make it whole for its fuel and purchased power costs.  
2 According to the Company's application, this situation purportedly  
3 constitutes an operating cash flow emergency, and a downgrade from  
4 financial rating agencies is represented as imminent in the absence of  
5 emergency relief.  
6

7 Q. To what does APS attribute its perceived state of emergency?

8 A. APS attributes the emergency to the Commission's failure to address its  
9 increased fuel costs, and the resultant threat of further financial  
10 downgrade to junk bond status by the Standard & Poor's (S&P) rating  
11 agency in December 2005.  
12  
13

14 Q. Didn't APS have a "growing fuel and purchased-power deferral" prior to  
15 Standard and Poor's December 2005 downgrade?

16 A. Yes. Pursuant to the Power Supply Adjustor (PSA) adopted in Decision  
17 No. 67744, APS had been deferring the difference between the cost of  
18 fuel and purchased power included in base rates and the cost APS was  
19 actually paying for these commodities. Thus, cost deferrals have been  
20 accruing since April 2005, when the rates set in Decision No. 67744 went  
21 into effect.  
22

1 Q. If the lack of cash flow and the growing deferral are such a problem, as  
2 claimed by APS, why did the rating agency wait until December 2005 to  
3 downgrade APS?

4 A. S&P waited to act because the problem actually was not the lack of cash  
5 flow and the growing deferral, as represented by APS. If this had been a  
6 major concern, the rating agency would have downgraded APS back in  
7 August 2005 when, according to APS, the deferrals were already \$100  
8 million. What caused S&P's action in December 2005 was its *perception*  
9 that the ACC was not going to deal with the growing deferrals in a timely  
10 manner.

11  
12 Q. How do you know that the rating agency's action in December 2005 was  
13 attributable to timing concerns?

14 A. S&P has stated as much in its rating reports. For example, it stated in its  
15 June 24, 2005 report that "APS' near-term challenges are largely related  
16 to regulatory lag." (see Exhibit 1) On October 4, 2005 S&P stated that  
17 "timely near-term cost collection will be the key driver of credit quality" and  
18 that "Standard & Poor's is becoming increasingly concerned with the  
19 utility's ability to achieve this." (see Exhibit 2) In the same report S&P  
20 noted that APS had filed an application for a PSA surcharge and stated  
21 that "Both the pace and the disposition of this proceeding will be critical to  
22 credit quality." (Id.) On December 21, 2005 S&P stated that it had lowered  
23 APS' credit ratings to BBB- and that "This action is based on increased

1 regulatory and operating risk at APS. Specifically, Standard & Poor's is  
2 concerned that the Arizona Corporation Commission (ACC) is not  
3 expeditiously addressing APS' growing fuel and purchased-power cost  
4 deferrals". (see Exhibit 3)

5  
6 Q. APS' testimony seems to attribute the rating agency's recent action not so  
7 much to the regulatory lag issue but to APS' Funds from Operations to  
8 Debt ratio (FFO/Debt). Please comment.

9 A. The FFO/Debt ratio measures the sufficiency of a company's cash flow to  
10 service its debt, and is one of three metrics used by S&P in its credit  
11 ratings. Further, metrics are not the only measures used by S&P in  
12 determining its credit ratings. S&P stated the following regarding its credit  
13 rating guidelines in its June 2, 2004 report: (see Exhibit 4)

14 It is important to emphasize that these metrics are only  
15 guidelines associated with the expectations for various rating  
16 levels. Although credit ratio analysis is an important part of  
17 the ratings process, these three statistics are by no means  
18 the only critical financial measure that Standard & Poor's  
19 uses in its analytical process.  
20

21 Q. What other indications do you have the FFO/Debt ratio is not the  
22 lynchpin criteria upon which the rating agency relies for its credit  
23 ratings?

24 A. S&P indicated in its December 21, 2005 report that APS' average  
25 FFO/Debt ratio was 14.8%. (see Exhibit 3) Under its own  
26 guidelines a BBB rating requires a 15% to 20% FFO/Debt ratio for



1 an issuer with a Business Profile of 6 to maintain a BBB rating. (see  
2 Exhibit 4) Yet, S&P in December 2005 rated APS BBB-/Stable,  
3 clearly demonstrating that the FFO/Debt ratio was not the  
4 controlling factor behind its credit rating for APS.

5  
6  
7 Q. At the time APS filed its emergency rate request was there any merit to  
8 the Company's claim of an emergency?

9 A. Perhaps. At the time the Company filed its emergency application,  
10 Standard and Poor's had down-graded APS to a BBB- debt rating and  
11 announced its intention to downgrade APS to junk bond status if the  
12 Arizona Corporation Commission did not "expeditiously" address APS'  
13 growing fuel and purchased-power deferral. (see Exhibit 3) Such a  
14 downgrade to junk status would have long-term detrimental effects on the  
15 Company and its ability to serve its growing customer base. Downgrade  
16 to junk status would also have constrained APS' access to debt, which  
17 would have constrained APS' ability to finance the infrastructure needed to  
18 serve its growing customer base.

19  
20 Q. What are the criteria used to determine if an emergency exists?

21 A. Under Attorney General Opinion 71-17, a utility must meet one of the  
22 three following criteria to merit emergency rate relief:

23 1) A company is insolvent;

1                   2)     A sudden change brings hardship to a company;

2                   3)     A company's condition is such that its ability to maintain  
3                   service pending a formal rate determination is in serious  
4                   doubt.

5  
6     Q.     As of today, does APS meet any of these three criteria?

7     A.     No. While prior to the issuance of Decision No. 68437 (February 2, 2006)  
8             there might have been a case to debate whether APS met criteria #3,  
9             since the issuance of that Decision there are no grounds for a finding of an  
10            emergency.

11  
12    Q.     Please explain.

13    A.     Decision No. 68437 accelerated the implementation of the PSA adjustor  
14             from April 1, 2006 to February 1, 2006. As a result, APS will recover  
15             approximately \$112 million of the deferred costs over the next year.<sup>1</sup> The  
16             acceleration of the adjustor also had the effect of accelerating APS  
17             eligibility for a surcharge. APS has recently filed that surcharge request.  
18             Decision No. 68437 also gave permission for APS to continue to defer  
19             costs over the \$776.2 cap imposed by Decision No. 67744. In Decision  
20             No. 68437 the Commission stated that it never was its intention that the  
21             cap create automatic disallowances of fuel and purchased power costs.  
22             Thus, there is no longer any basis for a *perception* by the rating agencies

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<sup>1</sup> The recovery authorized by Decision No. 68437 actually exceeds that requested by APS, which was \$80 million over 2 years.

1       that the ACC will not deal with the growing deferrals in a timely manner,  
2       and hence reduced threat of imminent downgrade to junk bond status.

3  
4   Q.   What assurance do you have that Decision No. 68437 obviates the threat  
5       of downgrade to junk bond status?

6   A.   The assurance comes in Standard and Poor's own statement in December  
7       2005 that its then-stable rating of BBB- for APS reflected Standard and  
8       Poor's expectation that the ACC would resolve at least a portion of APS'  
9       deferred costs in January 2006. (see Exhibit 3) If Standard and Poor's  
10      mere "expectation" that the ACC would grant some recovery of the  
11      deferral was sufficient to maintain a stable BBB- rating in December 2005,  
12      the ACC authorization of recovery of the deferrals in January 2006  
13      certainly should be sufficient to maintain the status quo rating of BBB-.  
14      Further, since the Commission voted on what became Decision No.  
15      68437<sup>2</sup>, two of the rating agencies have indicated that their present  
16      investment grade ratings are stable. On January 26, S&P affirmed its  
17      current BBB-, even though two days earlier it had reported that it  
18      appeared unlikely that the Commission would grant the pending  
19      emergency application. (see Exhibits 5 & 6) In addition, while Fitch  
20      downgraded APS' rating for senior unsecured debt from BBB+ to BBB on  
21      January 30, 2006, it reported a stable ratings outlook. (see Exhibit 7)  
22      Thus, the rating agencies view the Commission's actions in Decision No.

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<sup>2</sup> The Commission voted at its Open Meeting on January 25, 2006.

1           68437 as adequate to maintain APS' investment grade ratings for the time  
2           being.

3  
4   Q.    If there is no emergency, should interim rates be considered?

5   A.    No.   The criteria of Attorney General Opinion 71-17 must be met;  
6           otherwise, rates cannot be changed without a finding of fair value.

7  
8   Q.    Do you believe APS will be harmed by ACC denial of its emergency rate  
9           request?

10   A.   No.   With the threat of imminent junk bond status thwarted by: 1) the  
11           February 1, 2006 implementation of the PSA adjustor, 2) the recent APS  
12           application for a surcharge and 3) the pending rate case, there is no  
13           emergency. The appropriate action is to allow the PSA to operate as it  
14           was intended and to allow the pending rate case to look at APS' current  
15           cost of service on a comprehensive basis that considers all ratemaking  
16           elements. There is no need to implement interim rates when we have a  
17           PSA mechanism to make APS whole for any fuel and purchased power  
18           costs that exceed the Company's base cost, and a pending rate case that  
19           will allow a full vetting of the current cost of fuel and power, as well as all  
20           other elements of APS' cost of service.

1 Q. Did APS present any evidence that it will be unable to continue to provide  
2 electric service absent emergency interim rate relief?

3 A. No. In fact APS presented evidence to the contrary. On page 6 of APS'  
4 January 6, 2006 application for emergency rates the Company states:

5 Indeed, some 20% of the Company's meager 2006 return on  
6 equity of 6.6% will be comprised of nothing other than the  
7 Commission's assurance that these IOUs will be honored  
8 through actual cash recovery in APS rates.  
9

10 Thus, by APS' own admission the deferrals have only constrained 20% of  
11 its equity returns, which will not jeopardize the Company's ability to  
12 continue to provide service in the immediate future. The pending rate  
13 case can deal with these issues for the longer-term future.  
14

15 Q. Are there any other reasons why APS should not and need not receive an  
16 emergency interim rate increase?

17 A. Yes. Granting an emergency interim rate increase at this juncture would  
18 substantively change the terms of the settlement agreement and Decision  
19 No. 67744.  
20

21 Q. Please explain.

22 A. Decision No. 67744 required that any fuel and purchased power under- or  
23 over-recoveries were to be shared 90%/10% between stockholders and  
24 ratepayers. That Decision specifically stated that this sharing provision

1        was designed to be an "incentive".<sup>3</sup> The emergency interim rate request,  
2        if authorized, would circumvent this sharing mechanism and result in  
3        100% of the under-recovered fuel and purchased power costs being borne  
4        by ratepayers. Granting the emergency rates would, in essence, change  
5        the terms of the settlement agreement and Decision No. 67744, and harm  
6        ratepayers. Any revisiting of this sharing provision should take place in  
7        the pending full rate case, where it can be considered in the broader  
8        context of APS' overall rates.

9  
10    Q.    Does this conclude your direct testimony?

11    A.    Yes.  
12  
13  
14  
15  
16  
17

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<sup>3</sup> Decision No. 67744 at page 13, line 13

## APPENDIX I

## **APPENDIX I**

### **Qualifications of Marylee Diaz Cortez**

- EDUCATION:** University of Michigan, Dearborn  
B.S.A., Accounting 1989
- CERTIFICATION:** Certified Public Accountant - Michigan  
Certified Public Accountant - Arizona
- EXPERIENCE:** Audit Manager  
Residential Utility Consumer Office  
Phoenix, Arizona 85007  
July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst  
Residential Utility Consumer Office  
Phoenix, Arizona 85004  
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst  
Larkin & Associates - Certified Public Accountants  
Livonia, Michigan  
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted



of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

### **RESUME OF RATE CASE AND REGULATORY PARTICIPATION**

<b><u>Utility Company</u></b>	<b><u>Docket No.</u></b>	<b><u>Client</u></b>
Potomac Electric Power Co.	Formal Case No. 889	Peoples Counsel of District of Columbia
Puget Sound Power & Light Co.	Cause No. U-89-2688-T	U.S. Department of Defense - Navy
Northwestern Bell-Minnesota	P-421/EI-89-860	Minnesota Department of Public Service
Florida Power & Light Co.	890319-EI	Florida Office of Public Counsel
Gulf Power Company	890324-EI	Florida Office of Public Counsel
Consumers Power Company	Case No. U-9372	Michigan Coalition Against Unfair Utility Practices
Equitable Gas Company	R-911966	Pennsylvania Public Utilities Commission
Gulf Power Company	891345-EI	Florida Office of Public Counsel

Jersey Central Power & Light	ER881109RJ	New Jersey Department of Public Advocate Division of Rate Counsel
Green Mountain Power Corp.	5428	Vermont Department of Public Service
Systems Energy Resources	ER89-678-000 & EL90-16-000	Mississippi Public Service Commission
El Paso Electric Company	9165	City of El Paso
Long Island Lighting Co.	90-E-1185	New York Consumer Protection Board
Pennsylvania Gas & Water Co.	R-911966	Pennsylvania Office of Consumer Advocate
Southern States Utilities	900329-WS	Florida Office of Public Counsel
Central Vermont Public Service Co.	5491	Vermont Department of Public Service
Detroit Edison Company	Case No. U-9499	City of Novi
Systems Energy Resources	FA-89-28-000	Mississippi Public Service Commission
Green Mountain Power Corp.	5532	Vermont Department of Public Service
United Cities Gas Company	176-717-U	Kansas Corporation Commission

General Development Utilities	911030-WS & 911067-WS	Florida Office of Public Counsel
Hawaiian Electric Company	6998	U.S. Department of Defense - Navy
Indiana Gas Company	Cause No. 39353	Indiana Office of Consumer Counselor
Pennsylvania American Water Co.	R-00922428	Pennsylvania Office of Consumer Advocate
Wheeling Power Co.	Case No. 90-243-E-42T	West Virginia Public Service Commission Consumer Advocate Division
Jersey Central Power & Light Co.	EM89110888	New Jersey Department of Public Advocate Division of Rate Counsel
Golden Shores Water Co.	U-1815-92-200	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-92-135	Residential Utility Consumer Office
Sulphur Springs Valley Electric Cooperative	U-1575-92-220	Residential Utility Consumer Office
North Mohave Valley Corporation	U-2259-92-318	Residential Utility Consumer Office
Graham County Electric Cooperative	U-1749-92-298	Residential Utility Consumer Office

Graham County Utilities	U-2527-92-303	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-93-110	Residential Utility Consumer Office
Litchfield Park Service Co.	U-1427-93-156 & U-1428-93-156	Residential Utility Consumer Office
Pima Utility Company	U-2199-93-221 & U-2199-93-222	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-94-306	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-182	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-310 & U-1303-94-401	Residential Utility Consumer Office
Pima Utility Company	U-2199-94-439	Residential Utility Consumer Office
SaddleBrooke Development Co.	U-2492-94-448	Residential Utility Consumer Office
Boulders Carefree Sewer Corp.	U-2361-95-007	Residential Utility Consumer Office
Rio Rico Utilities	U-2676-95-262	Residential Utility Consumer Office
Rancho Vistoso Water	U-2342-95-334	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-95-491	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-473	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-417 et al.	Residential Utility Consumer Office

Paradise Valley Water	U-1303-96-283 & U-1303-95-493	Residential Utility Consumer Office
Far West Water	U-2073-96-531	Residential Utility Consumer Office
Southwest Gas Corporation	U-1551-96-596	Residential Utility Consumer Office
Arizona Telephone Company	T-2063A-97-329	Residential Utility Consumer Office
Far West Water Rehearing	W-0273A-96-0531	Residential Utility Consumer Office
SaddleBrooke Utility Company	W-02849A-97-0383	Residential Utility Consumer Office
Vail Water Company	W-01651A-97-0539 & W-01651B-97-0676	Residential Utility Consumer Office
Black Mountain Gas Company Northern States Power Company	G-01970A-98-0017 G-03493A-98-0017	Residential Utility Consumer Office
Paradise Valley Water Company Mummy Mountain Water Company	W-01303A-98-0678 W-01342A-98-0678	Residential Utility Consumer Office
Bermuda Water Company	W-01812A-98-0390	Residential Utility Consumer Office
Bella Vista Water Company Nicksville Water Company	W-02465A-98-0458 W-01602A-98-0458	Residential Utility Consumer Office
Paradise Valley Water Company	W-01303A-98-0507	Residential Utility Consumer Office
Pima Utility Company	SW-02199A-98-0578	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144 Interim Rates	Residential Utility Consumer Office

Vail Water Company	W-01651B-99-0355 Interim Rates	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144	Residential Utility Consumer Office
Sun City Water and Sun City West	W-01656A-98-0577 & SW-02334A-98-0577	Residential Utility Consumer Office
Southwest Gas Corporation ONEOK, Inc.	G-01551A-99-0112 G-03713A-99-0112	Residential Utility Consumer Office
Table Top Telephone	T-02724A-99-0595	Residential Utility Consumer Office
U S West Communications Citizens Utilities Company	T-01051B-99-0737 T-01954B-99-0737	Residential Utility Consumer Office
Citizens Utilities Company	E-01032C-98-0474	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-00-0309 & G-01551A-00-0127	Residential Utility Consumer Office
Southwestern Telephone Company	T-01072B-00-0379	Residential Utility Consumer Office
Arizona Water Company	W-01445A-00-0962	Residential Utility Consumer Office
Litchfield Park Service Company	W-01427A-01-0487 & SW-01428A-01-0487	Residential Utility Consumer Office
Bella Vista Water Co., Inc.	W-02465A-01-0776	Residential Utility Consumer Office
Generic Proceedings Concerning Electric Restructuring Issues	E-00000A-02-0051	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-02-0707	Residential Utility Consumer Office
Qwest Corporation	RT-00000F-02-0271	Residential Utility Consumer Office

Arizona Public Service Company	E-01345A-02-0403	Residential Utility Consumer Office
Citizens/UniSource	G-01032A-02-0598 E-01032C-00-0751 E-01933A-02-0914 E-01302C-02-0914 G-01302C-02-0914	Residential Utility Consumer Office
Arizona-American Water Company	WS-01303A-02-0867	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-03-0437	Residential Utility Consumer Office
UniSource	E-04230A-03-0933	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-04-0407	Residential Utility Consumer Office
Qwest Corporation	T-01051B-03-0454 & T-00000D-00-0672	Residential Utility Consumer Office
Tucson Electric Power Company	E-01933A-04-0408	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0280	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-04-0876	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0405	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0718	Residential Utility Consumer Office

## EXHIBITS

- |    |                   |                   |
|----|-------------------|-------------------|
| 1. | Standard & Poor's | June 24, 2005     |
| 2. | Standard & Poor's | October 4, 2005   |
| 3. | Standard & Poor's | December 21, 2005 |
| 4. | Standard & Poor's | June 2, 2004      |
| 5. | Standard & Poor's | January 26, 2006  |
| 6. | Standard & Poor's | January 24, 2006  |
| 7. | Fitch             | January 30, 2006  |



# **EXHIBIT 1**

**Standard & Poor's  
June 24, 2005**

## RESEARCH

**Summary: Arizona Public Service Co.**

Publication date: 24-Jun-2005  
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009;  
anne\_selting@standardandpoors.com

**Credit Rating:** BBB/Stable/A-2

**Rationale**

Arizona Public Service Co. (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp. (PWCC), and by far the most important company within the PWCC family. The ratings on APS and PWCC are based on the consolidated credit assessment method, resulting in the same corporate credit rating for the holding company and APS.

APS' business profile is satisfactory, a '5' on Standard & Poor's Ratings Services' 10-point scale (where '1' is excellent). Strengths specific to the utility include a Phoenix service territory that is the second-fastest growing region in the U.S. (behind Las Vegas), a diversified power supply portfolio, and the recent approval by the Arizona Corporation Commission (ACC) of a settlement in APS' rate case, which, through a 4.21% increase in retail rates and the addition of a fuel and purchased power costs adjuster, should modestly shore up a financial performance that has been weakening over the past several years.

APS' near-term challenges are largely related to regulatory lag. Timely recovery of costs incurred in the rate base will remain challenging for the utility, despite the recent completion of a major rate case. APS filed its recently completed rate case in June 2003, and the process that culminated in the settlement allowed a modest rate increase that took effect in April 2005, nearly two years later. Because these rates are based on a December 2002 test year, the utility will need to file a new rate case soon to reflect its significant capital expenditures and to keep current on its generation costs that are gradually becoming more concentrated in natural gas. While the fuel and purchased power adjuster is expected to provide some rate relief to the utility, the adjuster is capped at a level that will likely need to be revisited well before its expiration in five years. And, because load growth in APS' service territory is projected to grow about 4% per year over the next five years, APS will still need an additional 1,200 MW by the summer of 2007 to fill the gap between power supply and demand. APS recently issued a request for proposals to meet 1,000 MW of this demand.

PWCC's business profile of '5' reflects the most significant benefit of the APS settlement, which is the authorization that the utility received from the ACC to rate-base 1,790 MW of generation that is currently owned by Pinnacle West Energy Corp (PWEC), PWCC's non-regulated wholesale generation subsidiary. The transfer received Federal Energy Regulatory Commission (FERC) approval on June 15, 2005, and should be completed by August 2005. PWCC announced June 21, 2005, that it has reached an agreement to sell its 425 MW interest in Silverhawk to Nevada Power Co. (NPC; B+/Negative/NR) for \$208 million. PWCC expects it will recognize an after-tax loss of about \$55 million with the sale. The elimination of merchant operations from PWCC's consolidated operations, combined with the scaling back of activities of its three other unregulated subsidiaries--SunCor, El Dorado, and APS Energy Services--has improved consolidated business risks and should help to achieve improved financial metrics, which have been weakening since 2002 as a function of APS' need for rate adjustments and PWEC's merchant operations.

Consolidated financial metrics remained largely in line with the rating, but in part due to a change in how Standard & Poor's approaches operating leases (see Standard & Poor's article, "Corporate Ratings Criteria--Operating Lease Analytics," published June 9, 2005, on RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com)), 2004 consolidated adjusted funds from operations to total debt (FFO/TD) was weak at 14.1%. Additionally, due to the fact that APS retail rates were not increased until April 1, first-quarter FFO/TD metrics remain below benchmarks. Also negatively impacting FFO is an anticipated tax assessment of approximately \$100 million that is expected to be paid within the next year. The company's forecast expects 2005 metrics to stabilize, with expectations that FFO/TD will be approximately 17%. The cumulative impact of PWCC's \$250 million in equity issued in May, the realization of higher utility revenues through the rate increase, and the receipt of proceeds from the sale of Silverhawk, if completed, should help to achieve this expectation. However, the need for continued timely processing of APS' rate applications and reasonable rate relief will be critical to producing

consolidated long-term financial health.

### Short-term credit factors

PWCC's short-term rating is 'A-2'. The rating is supported by the consolidated corporate credit rating, the fact that the preponderance of cash flows are produced by APS, a vertically integrated electric utility, and the expectations for diminished capital and liquidity requirements at PWEC. As of March 31, 2005, PWCC's liquidity was ample, with consolidated cash and cash equivalents at about \$250 million. This very strong cash position is due largely to APS' issuance of \$300 million in notes in June 2004 in order to pre-finance about \$400 million in utility obligations due in January and August 2005.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of March 31, 2005. PWCC's program is for \$250 million and is supported by a three-year, \$300 million credit facility that PWCC put into place in October 2004. The revolver allows PWCC to use up to \$100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be \$770 million in 2005 (which includes \$190 million for the purchase of the Sundance power plant), up significantly from \$484 million in 2004. APS maintains a \$250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to \$325 million. Also a three-year term, the facility supports the utility's CP program and provides an additional \$75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

### Outlook

The stable outlook reflects Standard & Poor's expectation that PWCC will continue to focus on the regulated operations of APS, which is projected to contribute more than 85% of its funds from operations in 2005. The failure of PWCC or APS to meet expected financial results in 2005 and 2006, particularly in light of the weakening in consolidated and utility credit metrics in 2004, could lead to a downward revision of the outlook or a ratings change. Downward pressure on the ratings will occur if APS incurs significant power or fuel cost deferrals in excess of the fuel and purchased power adjuster's limitations. Any positive rating action is unlikely in the near term given the financial metrics and the longer-term risks that the limitations placed on APS' power supply adjuster present.

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## **EXHIBIT 2**

**Standard & Poor's  
October 4, 2005**

## RESEARCH

**Summary: Arizona Public Service Co.**

Publication date: 04-Oct-2005  
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009;  
anne\_selting@standardandpoors.com

**Credit Rating:** BBB/Stable/A-2

**Rationale**

Arizona Public Service Co. (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp. (PWCC), and the most significant company within the PWCC family. PWCC's satisfactory business profile (a '5' on a 10-point scale where '1' is excellent) reflects the vertically integrated utility operations of APS and the absence of significant non-regulated businesses within PWCC.

APS' credit strengths include a Phoenix service territory that is the second-fastest growing region in the U.S. (behind Las Vegas), a diversified power supply portfolio, and a 4.21% increase in retail rates that began on April 1, 2005 in conjunction with the settlement of the utility's general rate case in March 2005. This increase had been expected to modestly shore up a financial performance that has been weakening over the past several years.

However, challenges are increasing for the utility, and performance on a 12-month rolling basis ended June 30, 2005 indicates that the utility is pressured by the rising costs of purchased power and natural gas. The addition of a fuel and purchased power cost adjuster to retail rates has not assisted APS in timely receipt of cash because revisions occur only in the spring of each year, with the first opportunity arising in April 2006. The settlement provides for the use of a surcharge filing to provide the utility with an interim vehicle for recovering costs if they exceed \$50 million. As anticipated, APS did accrue this level of deferrals over the summer. Through June 30, 2005, purchased power and fuel costs totaled \$401 million, of which \$34 million was deferred. At Aug. 31, 2005, the deferred balance had increased to \$117 million. The company's estimates of total fuel and purchased power costs in 2005 are confidential, but as a basis of comparison, in 2004 the utility spent \$763 million. In July 2005, APS filed an application with the Arizona Corporation Commission (ACC) requesting that it be allowed to recover \$100 million through a two-year surcharge that would increase rates by about 2.2%.

Both the pace and disposition of this proceeding will be critical to credit quality. The ACC staff and at least one commissioner have questioned whether the utility should be allowed to collect \$20 million of the \$100 million requested, the former being the amount roughly associated with Palo Verde replacement power costs during four months from April through July 2005. (Since then, Units 1 and 2 suffered outages in late August.) In late September, the company announced that to expedite an ACC decision, it would reduce its request for surcharge recovery to \$80 million and address the \$20 million in deferred costs in a later proceeding. The ACC has established a schedule for the proceeding to address the \$80 million, with hearings to begin Oct. 26, 2005.

For fiscal 2005, the company continues to expect it will achieve results in line with credit metrics needed to support the current rating. And in April 2006, the utility will be able to receive additional relief through the annual fuel and purchased power adjustment mechanism. But upward adjustments are limited to 4 mills/kWh over the life of the adjuster. Because existing retail rates are based on 2003 costs, reflecting gas prices of about \$5.50/MMBtu, the company expects the entire 4 mill headroom will be utilized at the first reset. The utility is expected to file another rate case by the end of 2005, but its resolution could extend well into 2006. Thus, it is clear that timely near-term cost collection will be the key driver of credit quality. Standard & Poor's is becoming increasingly concerned with the utility's ability to achieve this. A relatively weak power supply adjustment mechanism, in combination with rapidly escalating and volatile gas prices, as well as the potential for a protracted surcharge proceeding, could cause deterioration in financial performance which, year to date, has been sub par for the rating.

Whether the company's consolidated targets will be met will largely be a function of APS' third-quarter results. For the 12 months ending June 30, 2005, consolidated adjusted funds from operations (FFO) to total debt was 12.7%, but this reflects a one-time deferred tax charge taken in December 2004 based on

the expectation that APS may need to refund \$130 million at the end of 2005. Excluding the deferral, adjusted FFO/total debt is closer to 15.5%. FFO to interest coverage was 3.0x for the 12 months ending June 30, or 3.5x when the deferred tax obligation is excluded. Adjusted debt to total capitalization was 55.7% and benefited from PWCC's April issuance of \$250 million in equity.

APS' general rate case settlement allowed for the rate-basing of 1,790 MW of Arizona generation formerly owned by Pinnacle West Energy Corp (PWEC), PWCC's merchant generation subsidiary. In July 2005, PWEC transferred this generation capacity, through five plants, to APS. PWCC has also announced that it plans to sell its remaining 75% interest in Silverhawk, a 570 MW plant near Las Vegas, Nev., to Nevada Power (NPC; B+/Positive/NR) for \$208 million. If Nevada regulators approve the sale, the transaction should be completed by the end of 2005 and mark the complete wind-down of PWEC operations. Consolidated credit benefited from the transfer by reducing merchant exposure in providing APS with needed supply to meet its growing loads.

### Short-term credit factors

PWCC's short-term rating is 'A-2'. The rating is supported by the fact that the preponderance of cash flows is produced by APS, a vertically integrated electric utility. Near-term liquidity is adequate to support power purchase expenses that exceed rates. Because APS is heading into its shoulder season, when demand for electricity for space cooling drops significantly, the build-up of its power cost deferrals should slow. APS has hedged nearly all of its power and gas purchases through the remainder of 2005 and about 80% in 2006, thus its cost projections should be in line with realizations. Consolidated cash and investments stood at more than \$900 million as of Sept. 31, 2005. However, \$500 million was used on Oct. 3, 2005 to call the Pinnacle West Energy Company's floating-rate notes due April 2007. Also impacting the cash and invested position is the increased amount of collateral held under hedging contracts.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of June 30, 2005. PWCC's program is for \$250 million and is supported by a three-year, \$300 million credit facility that expires in October 2007. The revolver allows PWCC to use up to \$100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be about \$770 million in 2005 (and includes \$190 million for the purchase of the Sundance power plant), up significantly from \$484 million in 2004. APS maintains a \$250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to \$325 million. This facility, also a three-year term, expires in May 2007, supports the utility's CP program, and provides an additional \$75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

### Outlook

The stable outlook reflects Standard & Poor's expectation that the ACC will resolve APS' large deferred power costs through a surcharge ruling no later than year-end that supports timely recovery of the \$80 million request. In addition, the outlook presumes that third-quarter consolidated financial results will reflect improvements that demonstrate modest advances in credit metrics. An adverse outcome in either of these areas will result in a negative outlook. No positive ratings changes are expected in short-term.

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## **EXHIBIT 3**

**Standard & Poor's  
December 21, 2005**

## RESEARCH

## Research Update: Pinnacle West Capital's, Arizona Public Service's Ratings Lowered To 'BBB-'; Outlook Stable

Publication date: 21-Dec-2005  
Primary Credit Analyst: Anne Selling, San Francisco (1) 415-371-5009;  
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Credit Rating: BBB-/Stable/A-3

### Rationale

On Dec. 21, 2005, Standard & Poor's Ratings Services lowered its corporate credit ratings on Pinnacle West Capital Corp. (PWCC) and principal electric utility subsidiary Arizona Public Service Co. (APS) to 'BBB-' from 'BBB'. The outlook is stable.

This action is based on increased regulatory and operating risk at APS. Specifically, Standard & Poor's is concerned that the Arizona Corporation Commission (ACC) is not expeditiously addressing APS' growing fuel and purchased-power cost deferrals, which have grown much more rapidly than expected in 2005, particularly because of elevated gas prices and the utility's increased dependence on this fuel. In November 2005, APS filed for a nearly 20% increase in customer electric rates, but it appears unlikely that a resolution will be reached until 2007, and may be delayed to mid-2007. Combined with a year of weaker-than-expected performance at the historically reliable Palo Verde nuclear station, Standard & Poor's now views the business profile of PWCC and APS as a satisfactory '6' (on a 10-point scale where '1' is excellent) and no longer a '5'.

APS's fuel and purchased-power cost deferrals were nearly \$150 million as of Sept. 30, 2005. Because the ACC has not acted on the utility's request to recover a portion of this amount in a surcharge, this entire balance, and any new additions through Dec. 31 will be carried into 2006. Standard & Poor's estimates that the utility may incur an additional \$265 million in deferral balances by year-end 2006. Actual balances will be a function of how the ACC addresses existing amounts, as well as forward market prices and the company's hedged positions. To date, APS has hedged about 85% of its purchased power and natural gas fuel price risk for its retail load in 2006 and 65% in 2007.

A surcharge proceeding that would resolve \$80 million of the utility's current deferrals has been before the commission for five months. The surcharge process was mandated by the ACC as part of the settlement of APS's 2003 rate case that it approved in March 2005. APS is required to notify the ACC when its fuel and purchased-power deferrals reach \$50 million and to file a plan for recovery before deferrals exceed \$100 million. In July 2005, the utility filed an application to recover about \$100 million through a two-year surcharge, but reduced it to \$80 million to exclude Palo Verde outage related costs, which will be addressed in a later proceeding. If approved, residential rates would increase about 1.6%.

Since the fall of 2005, Standard & Poor's has conditioned a stable outlook on the satisfactory resolution of this portion of deferrals before year-end. Yet, because of the sustained increase in deferrals, even if the surcharge is implemented, it will likely resolve only about one-half of the company's expected deferred balances at year-end 2005.

Beyond the surcharge, additional 2005 deferred balances can be addressed through an adjustment to the company's power supply adjuster (PSA). However, the PSA has several limitations. It allows APS to collect 90% of the difference between actual fuel, purchased power, and associated hedging costs and those reflected in retail rates. But as per the settlement, APS may not be granted an adjustment before April 2006. Until then the PSA is set at zero. This is problematic because retail rates



reflect fuel and purchased-power costs based on 2003 costs when the price of natural gas averaged about \$5.50 per million BTU. In addition to a certain wait of four months for PSA adjustments to be authorized, upward adjustments are capped at 4 mils per kilowatt-hours for the life of the mechanism. As a result, all or nearly all of the PSA capacity is likely to be absorbed in APS's first PSA filing, and the utility is expected to end the summer of 2006 needing another surcharge to address additional balances that will accumulate. Thus, any rate relief granted for remaining 2005 deferrals will not completely resolve the issue because the onset of the utility's summer cooling season in late April will contribute additional amounts to deferred balances.

APS's new general rate case request totals \$409.1 million (19.9%) increase in annual revenues. About \$247 million of the request is related to increased fuel and purchased-power costs. Recent public statements by the ACC suggest spring 2007 may be the earliest a decision could be expected. APS's last rate case took nearly 23 months to conclude, and there is therefore substantial uncertainty as to when the case will be completed.

An additional factor contributing to PWCC's weakened business profile is the performance of the Palo Verde nuclear units in 2005. The three-unit facility typically supplies 25% to 30% of the utility's energy requirements. In 2005, the combined capacity factor for the three units is expected to be about 78%, against the company's forecast of 86%. While some of the deterioration reflects the expected increase in Unit 1's refueling outage to 75 days from 33 days, enabling the replacement of the unit's steam turbine generators, the units have been beset by a series of operational problems, which include an overhang of issues first raised by the NRC in 2004. Specifically, in the summer of 2004, the company identified piping in a portion of the emergency cooling system that was dry, a situation that the NRC flagged as "yellow," the second-most serious of four categories of violations.

The yellow flag triggered onsite NRC inspections in the fall of 2005. On Oct. 11, 2005, Units 2 and 3 were taken off line after NRC officials posed questions as to how the emergency cooling systems might operate under a range of hypothetical scenarios. The plants were brought back into service 10 days later, after the company successfully demonstrated that the cooling systems would operate as designed. An NRC inspection report related to the cooling system issues is expected in December 2005. Other operational problems have also occurred. In the spring of 2005, problems with the pressurizer heating elements in Unit 3 resulted in the extension of a planned 10-day outage to 32 days. In September, APS announced that day-to-day management of Palo Verde has been reorganized.

PWCC's consolidated cash coverage metrics are expected to be largely in line with 2004 results, which were very weak due to APS's delayed rate relief. For the 12 months ending Sept. 30, adjusted funds from operations (FFO) to interest coverage was 3.3x, identical to coverage at the end of 2004. The 12-month adjusted FFO to total debt was 14.8%, and reflects about \$80 million in cash flows from Suncor assets sales that will not be realized in 2006 at this level. Future cash flow metrics will depend significantly on the ACC's actions, but are generally not expected to display any significant improvement through 2006 due to a continued build up of deferrals. Performance in 2007 will be heavily predicated on how long it takes for the ACC to rule on the company's base rate increase. Due in large part to PWCC's April 2005 issuance of \$250 million in common stock, adjusted debt to total capitalization remains solid at 53%. However, borrowing requirements could rise in 2006 to fund APS's additional power and fuel costs deferrals and to invest in capital expenditures.

### Short-term credit factors

PWCC's short-term rating is 'A-3'. The rating is supported by the preponderance of cash flows being produced by APS, a vertically integrated electric utility. Because of APS's sizable commercial paper program, near-term liquidity should be adequate to support cash outlays for power and fuel not recoverable in rates. And, because APS is heading into its winter season, when demand for electricity for space cooling drops significantly, the build-up of its power cost deferrals should slow. APS has hedged most of its power and gas purchases remaining in 2005, 85% of 2006 requirements, and about 65% for 2007.

Consolidated cash and investments stood at more than \$900 million as of Sept. 30, 2005. However, \$500 million was used on Oct.

3, 2005 to call Pinnacle West Energy Corp.'s (PWEC) floating-rate notes that were due April 2007. Also affecting the cash and invested position is the increased amount of collateral held under bilateral contracts.

PWCC and APS maintain commercial paper programs. Neither program had any balances as of Dec. 20, 2005. PWCC's program is for \$250 million and is supported by a five-year, \$300 million credit facility that expires in December 2010. The revolver allows PWCC to use up to \$100 million of the facility for letters of credit. The revolver has no material adverse change clauses.

APS's short-term rating is also 'A-3'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be about \$800 million in 2005 (and includes \$190 million for the purchase of the Sundance power plant), up significantly from \$484 million in 2004. APS maintains a \$250 million commercial paper program. APS has a five-year, \$400 million revolver that expires in December 2010 that supports its commercial paper program, and also provides an additional \$150 million for other liquidity needs, including \$100 million for letters of credit. The supporting facility has no material adverse change clauses. Consolidated maturities are modest and consist of \$384 million in 2006, of which \$300 million is a note at the parent, which is due in April. Currently, there are virtually no obligations due in 2007, as PWEC called at par in early October some \$500 million in notes that it issued in April 2005 to retire an intercompany loan between PWEC and APS that was associated with the PWEC assets now owned by APS.

## Outlook

The stable outlook reflects Standard & Poor's expectation that the ACC will resolve at least a portion of APS's increasing deferred power costs in January 2006. In addition, the outlook presumes that progress will be made in addressing APS' general rate case and that any outcome will support the return of consolidated financial metrics to what until 2004 was a reasonable performance. The stable outlook is also dependent on improved 2006 performance at Palo Verde. Any adverse regulatory development or continued delays in resolving the pending surcharge request could result in a downward revision of the outlook or an adverse rating action. Because no meaningful improvement in the consolidated financial profile is expected in the near term, the potential for positive rating changes does not currently exist.

## Ratings List

### Ratings Lowered

Pinnacle West Capital Corp.	To	From
Corp credit rating	BBB-/Stable/A-3	BBB/Stable/A-2
Senior unsecured debt	BB+	BBB-
Commercial paper	A-3	A-2
Arizona Public Service Co.		
Corp credit rating	BBB-/Stable/A-3	BBB/Stable/A-2
Senior unsecured debt	BBB-	BBB
Commercial paper	A-3	A-2

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

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## **EXHIBIT 4**

**Standard & Poor's  
June 2, 2004**

## RESEARCH

## New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised

Publication date:

02-Jun-2004

Credit Analyst:

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Standard & Poor's Ratings Services has assigned new business profile scores to U.S. utility and power companies to better reflect the relative business risk among companies in the sector. Standard & Poor's also has revised its published risk-adjusted financial guidelines. The new business scores and financial guidelines do not represent a change to Standard & Poor's ratings criteria or methodology, and no ratings changes are anticipated from the new business profile scores or revised financial guidelines.

### New Business Profile Scores and Revised Financial Guidelines

Standard & Poor's has always monitored changes in the industry and altered its business risk assessments accordingly. This is the first time since the 10-point business profile scale for U.S. investor-owned utilities was implemented that a comprehensive assessment of the benefits and the application of the methodology has been made. The principal purpose was to determine if the methodology continues to provide meaningful differentiation of business risk. The review indicated that while business profile scoring continues to provide analytical benefits, the complete range of the 10-point scale was not being utilized to the fullest extent.

Standard & Poor's has also revised the key financial guidelines that it uses as an integral part of evaluating the credit quality of U.S. utility and power companies. These guidelines were last updated in June 1999. The financial guidelines for three principal ratios (funds from operations (FFO) interest coverage, FFO to total debt, and total debt to total capital) have been broadened so as to be more flexible. Pretax interest coverage as a key credit ratio was eliminated.

Finally, Standard & Poor's has segmented the utility and power industry into sub-sectors based on the dominant corporate strategy that a company is pursuing. Standard & Poor's has published a new U.S. utility and power company ranking list that reflects these sub-sectors.

There are numerous benefits to the reassessment. Fuller utilization of the entire 10-point scale provides a superior relative ranking of qualitative business risk. A simultaneous revision of the financial guidelines supports the goal of not causing rating changes from the recalibration of the business profiles. Classification of companies by sub-sectors will ensure greater comparability and consistency in ratings. The use of industry segmentation will also allow more in-depth statistical analysis of ratings distributions and rating changes.

The reassessment does not represent a change to Standard & Poor's criteria or methodology for determining ratings for utility and power companies. Each business profile score should be considered as the assignment of a new score; these scores do not represent improvement or deterioration in our assessment of an individual company's business risk relative to the previously assigned score. The financial guidelines continue to be risk-adjusted based on historical utility and industrial medians. Segmentation into industry sub-sectors does not imply that specific company characteristics will not weigh heavily into the assignment of a company's business profile score.

### Results

Previously, 83% of U.S. utility and power business profile scores fell between '3' and '6', which clearly does not reflect the risk differentiation that exists in the utility and power industry today. Since the 10-point scale was introduced, the industry has transformed into a much less homogenous industry, where the divergence of business risk—particularly regarding management, strategy, and degree of competitive market exposure—has created a much wider spectrum of risk profiles. Yet over the same period, business profile scores actually converged more tightly around a median score of '4'. The new business profile scores, as of the date of this publication, are shown in Chart 1. The overall median business profile score

is now '5'.

Chart 1  
Distribution of Business Profile Scores

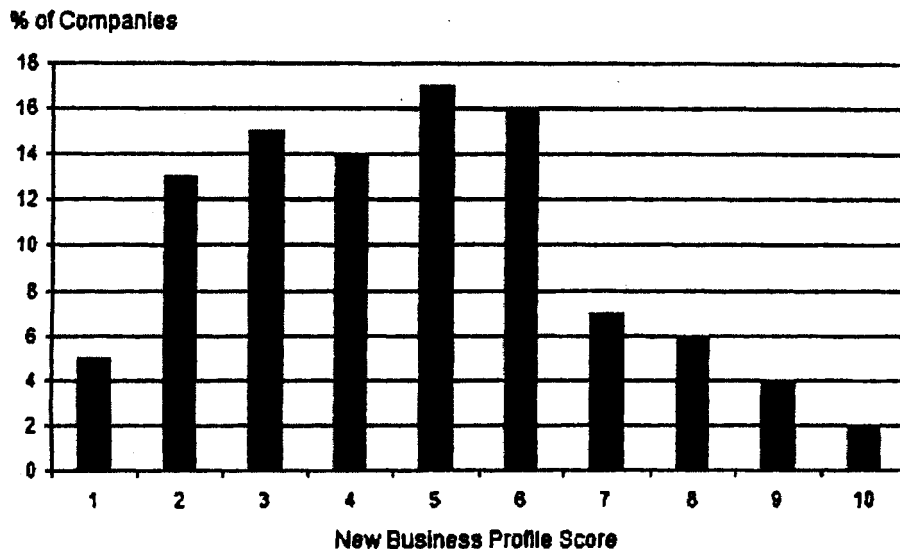


Table 1 contains the revised financial guidelines. It is important to emphasize that these metrics are only guidelines associated with expectations for various rating levels. Although credit ratio analysis is an important part of the ratings process, these three statistics are by no means the only critical financial measures that Standard & Poor's uses in its analytical process. We also analyze a wide array of financial ratios that do not have published guidelines for each rating category.

Table 1 Revised Financial Guidelines									
Funds from operations/interest coverage (x)									
Business Profile	AA		A		BBB		BB		
1	3	2.5	2.5	1.5	1.5	1			
2	4	3	3	2	2	1			
3	4.5	3.5	3.5	2.5	2.5	1.5	1.5	1	
4	5	4.2	4.2	3.5	3.5	2.5	2.5	1.5	
5	5.5	4.5	4.5	3.8	3.8	2.8	2.8	1.8	
6	6	5.2	5.2	4.2	4.2	3	3	2	
7	8	6.5	6.5	4.5	4.5	3.2	3.2	2.2	
8	10	7.5	7.5	5.5	5.5	3.5	3.5	2.5	
9			10	7	7	4	4	2.8	
10			11	8	8	5	5	3	
Funds from operation/total debt (%)									
Business Profile	AA		A		BBB		BB		
1	20	15	15	10	10	5			
2	25	20	20	12	12	8			
3	30	25	25	15	15	10	10	5	
4	35	28	28	20	20	12	12	8	
5	40	30	30	22	22	15	15	10	
6	45	35	35	28	28	18	18	12	
7	55	45	45	30	30	20	20	15	

8	70	55	55	40	40	25	25	15
9			65	45	45	30	30	20
10			70	55	55	40	40	25
<b>Total debt/total capital (%)</b>								
<b>Business Profile</b>	<b>AA</b>		<b>A</b>		<b>BBB</b>		<b>BB</b>	
1	48	55	55	60	60	70		
2	45	52	52	58	58	68		
3	42	50	50	55	55	65	65	70
4	38	45	45	52	52	62	62	68
5	35	42	42	50	50	60	60	65
6	32	40	40	48	48	58	58	62
7	30	38	38	45	45	55	55	60
8	25	35	35	42	42	52	52	58
9			32	40	40	50	50	55
10			25	35	35	48	48	52

Again, ratings analysis is not driven solely by these financial ratios, nor has it ever been. In fact, the new financial guidelines that Standard & Poor's is incorporating for the specified rating categories reinforce the analytical framework whereby other factors can outweigh the achievement of otherwise acceptable financial ratios. These factors include:

- Effectiveness of liability and liquidity management;
- Analysis of internal funding sources;
- Return on invested capital;
- The record of execution of stated business strategies;
- Accuracy of projected performance versus actual results, as well as the trend;
- Assessment of management's financial policies and attitude toward credit; and
- Corporate governance practices.

Charts 2 through 6 show business profile scores broken out by industry sub-sector. The five industry sub-sectors are:

- Transmission and distribution--Water, gas, and electric;
- Transmission only--Electric, gas, and other;
- Integrated electric, gas, and combination utilities;
- Diversified energy and diversified nonenergy; and
- Energy merchant/power developer/trading and marketing companies.

Chart 2  
Transmission and Distribution--Water, Gas, and Electric

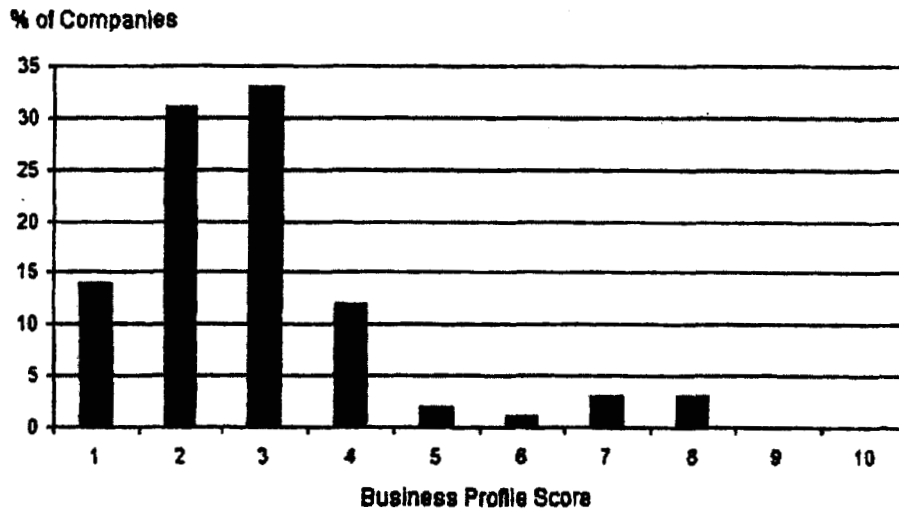
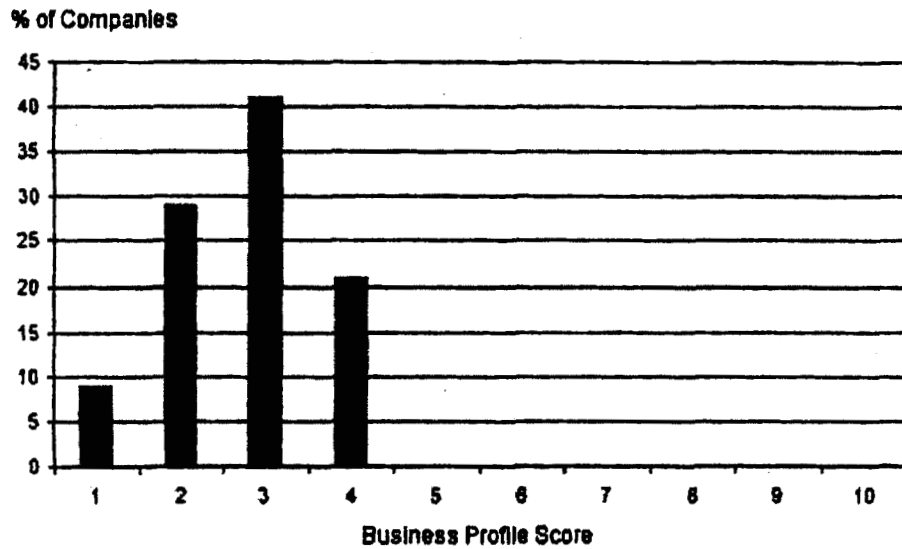
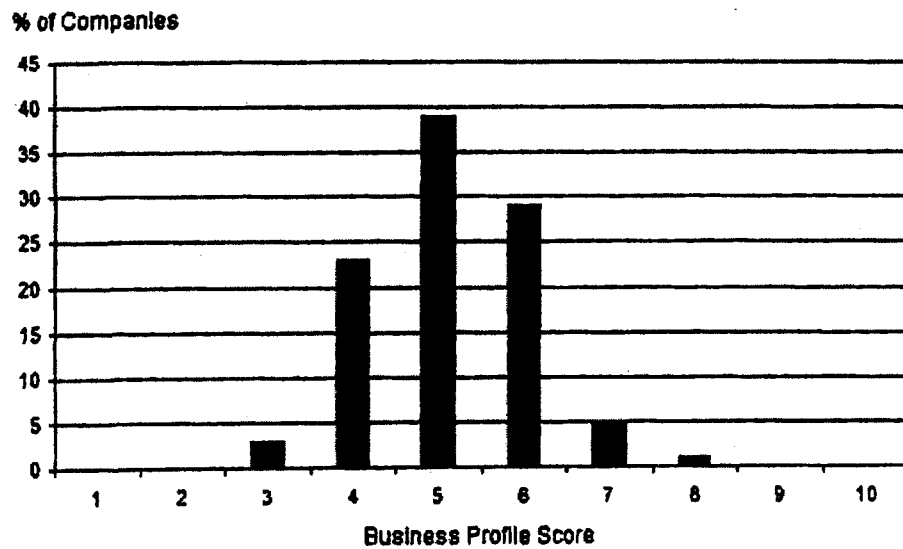


Chart 3  
Transmission Only--Electric, Gas, and Other





**Chart 4**  
**Integrated Electric, Gas, and Combination Utilities**



**Chart 5**  
**Diversified Energy and Diversified Non-Energy**

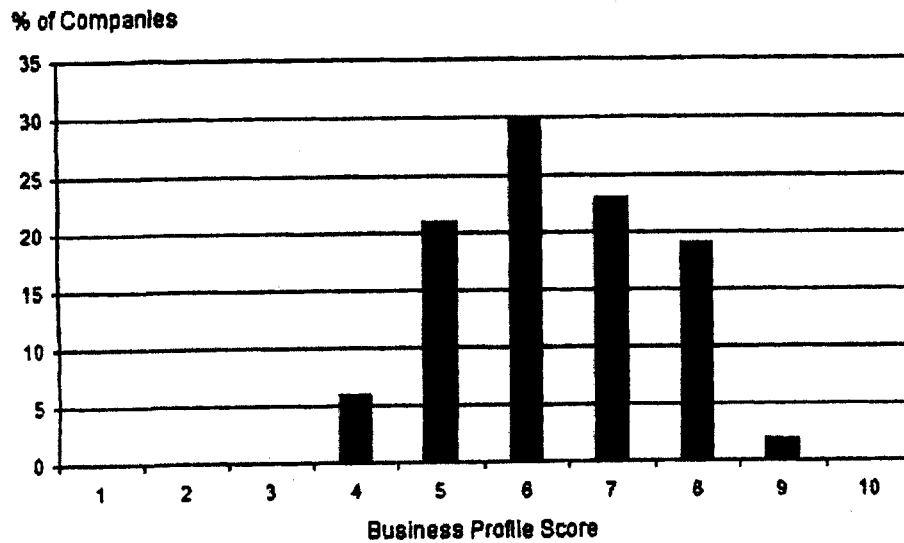
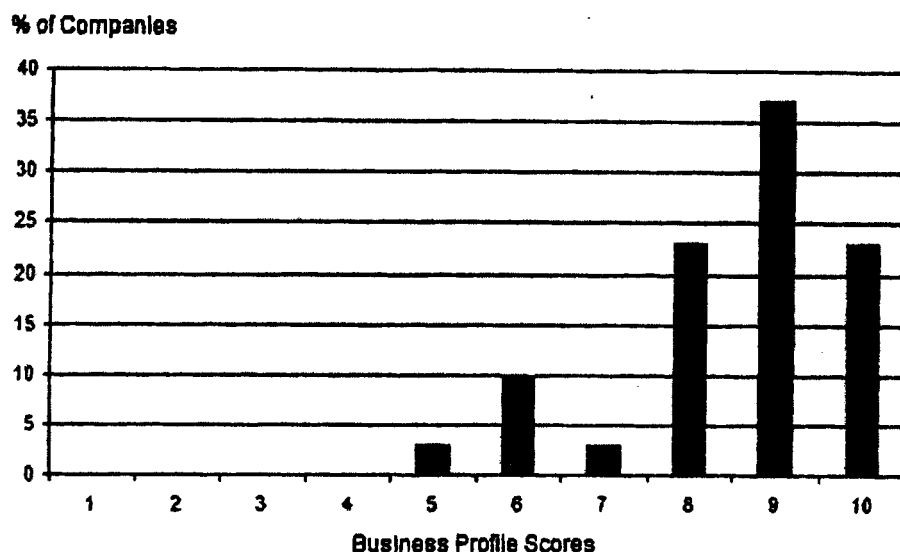


Chart 6

## Energy Merchant/Developers/Trading and Marketing



The average business profile scores for transmission and distribution companies and transmission-only companies are lower on the scale than the previous averages, while the average business profile scores for integrated utilities, diversified energy, and energy merchants and developers are higher.

The Appendix provides the company list of business profile scores segmented by industry sub-sector and ranked in order of credit rating, outlook, business profile score, and relative strength.

### Business Profile Score Methodology

Standard & Poor's methodology of determining corporate utility business risk is anchored in the assessment of certain specific characteristics that define the sector. We assign business profile scores to each of the rated companies in the utility and power sector on a 10-point scale, where '1' represents the lowest risk and '10' the highest risk. Business profile scores are assigned to all rated utility and power companies, whether they are holding companies, subsidiaries or stand-alone corporations. For operating subsidiaries and stand-alone companies, the score is a bottom-up assessment. Scores for families of companies are a composite of the operating subsidiaries' scores. The actual credit rating of a company is analyzed, in part, by comparing the business profile score with the risk-adjusted financial guidelines.

For most companies, business profile scores are assessed using five categories; specifically, regulation, markets, operations, competitiveness, and management. The emphasis placed on each category may be influenced by the dominant strategy of the company or other factors. For example, for a regulated transmission and distribution company, regulation may account for 30% to 40% of the business profile score because regulation can be the single-most important credit driver for this type of company. Conversely, competition, which may not exist for a transmission and distribution company, would provide a much lower proportion (e.g., 5% to 15%) of the business profile score.

For certain types of companies, such as power generators, power developers, oil and gas exploration and production companies, or nonenergy-related holdings, where these five components may not be appropriate, Standard & Poor's will use other, more appropriate methodologies. Some of these companies are assigned business profile scores that are useful only for relative ranking purposes.

As noted above, the business profile score for a parent or holding company is a composite of the business profile scores of its individual subsidiary companies. Again, Standard & Poor's does not apply rigid guidelines for determining the proportion or weighting that each subsidiary represents in the overall business profile score. Instead, it is determined based on a number of factors. Standard & Poor's will analyze each subsidiary's contribution to FFO, forecast capital expenditures, liquidity requirements, and other parameters, including the extent to which one subsidiary has higher growth. The weighting is determined case-by-case.

## Appendix: U.S. Utility and Power Company Ranking List

U.S. Utility and Power Company Ranking List		
Company	Corporate Credit Rating	Business Profile
<b>1. Regulated Transmission and Distribution - Electric, Gas, and Water</b>		
Baton Rouge Water Works Co. (The)	AA/Stable/-	1
Nicor Gas Co.	AA/Stable/A-1+	2
Nicor Inc.	AA/Stable/A-1+	3
Washington Gas Light Co.	AA-/Stable/A-1+	2
WGL Holdings Inc.	AA-/Stable/A-1+	3
New Jersey Natural Gas Co.	A+/Stable/A-1	1
Aqua Pennsylvania	A+/Stable/-	2
KeySpan Energy Delivery Long Island	A+/Negative/-	1
KeySpan Energy Delivery New York	A+/Negative/-	1
Elizabethtown Water Co.	A+/Negative/-	2
California Water Service Co.	A+/Negative/-	3
Questar Gas Co.	A+/Negative/-	3
Southern California Gas Co.	A/Stable/A-1	1
Boston Edison Co.	A/Stable/A-1	1
Commonwealth Electric Co.	A/Stable/-	1
Cambridge Electric Light Co.	A/Stable/-	1
NSTAR	A/Stable/A-1	1
Massachusetts Electric Co.	A/Stable/A-1	1
Narragansett Electric Co.	A/Stable/A-1	1
Northwest Natural Gas Co.	A/Stable/A-1	1
Connecticut Water Service Inc.	A/Stable/-	2
Connecticut Water Co. (The)	A/Stable/-	2
Aquarion Co.	A/Stable/-	2
Aquarion Water Co. of Connecticut	A/Stable/-	2
NSTAR Gas Co.	A/Stable/-	2
Piedmont Natural Gas Co. Inc.	A/Stable/A-1	2
National Grid USA	A/Stable/A-1	2
Consolidated Edison Co. of New York Inc.	A/Stable/A-1	2
Orange and Rockland Utilities Inc.	A/Stable/A-1	2
Rockland Electric Co.	A/Stable/-	2
Consolidated Edison Inc.	A/Stable/A-1	2
Laclede Gas Co.	A/Stable/A-1	3
Laclede Group Inc.	A/Stable/-	3
Atlantic City Sewerage Co.	A/Stable/-	3
Niagara Mohawk Power Corp.	A/Stable/-	3
Central Hudson Gas & Electric Co.	A/Stable/-	3
American Water Capital Corp.	A/Negative/	2
Boston Gas Co.	A/Negative/-	2
Colonial Gas Co.	A/Negative/-	2
Middlesex Water Co.	A/Negative/-	3
York Water Co. (The)	A-/Stable/-	2
Alabama Gas Corp.	A-/Stable/-	2
Atlanta Gas Light Co.	A-/Stable/-	2
Public Service Co. of North Carolina Inc.	A-/Stable/A-2	2
Wisconsin Gas Co.	A-/Stable/A-2	2
North Shore Gas Co.	A-/Stable/A-2	2

Peoples Gas Light & Coke Co.	A-/Stable/A-2	2
ONEOK Inc.	A-/Stable/A-2	6
Indiana Gas Co. Inc.	A-/Negative/—	1
Southern California Water Co.	A-/Negative/—	3
American States Water Co.	A-/Negative/—	3
United Water New Jersey	A-/Negative/—	4
United Waterworks	A-/Negative/—	4
PPL Electric Utilities Corp.	A-/Negative/—	4
Commonwealth Edison Co.	A-/Negative/A-2	4
PECO Energy Co.	A-/Negative/A-2	4
Central Illinois Public Service Co.	A-/CW-Neg/—	3
Western Massachusetts Electric Co.	BBB+/Stable/—	1
Cascade Natural Gas Corp.	BBB+/Stable/—	2
South Jersey Gas Co.	BBB+/Stable/—	2
Baltimore Gas & Electric Co.	BBB+/Stable/A-2	3
Connecticut Natural Gas Corp.	BBB+/Negative/—	3
Southern Connecticut Gas Co.	BBB+/Negative/—	3
Central Maine Power Co.	BBB+/Negative/—	3
Atlantic City Electric Co.	BBB+/Negative/A-2	3
Potomac Electric Power Co.	BBB+/Negative/A-2	3
Delmarva Power & Light Co.	BBB+/Negative/A-2	3
Yankee Gas Services Co.	BBB+/Negative/—	3
Connecticut Light & Power Co.	BBB+/Negative/—	3
UGI Utilities Inc.	BBB+/Negative/—	4
Bay State Gas Co.	BBB/Stable/—	2
AEP Texas Central Co.	BBB/Stable/—	2
AEP Texas North Co.	BBB/Stable/—	2
Southwest Gas Corp.	BBB-/Stable/—	3
Columbus Southern Power Co.	BBB/Stable/—	3
Ohio Power Co.	BBB/Stable/—	3
Public Service Electric & Gas Co.	BBB/Stable/A-2	3
Oncor Electric Delivery Co.	BBB/Negative/—	2
Southern Union Co.	BBB/Negative/—	3
Centerpoint Energy Houston Electric LLC	BBB/Negative/—	3
CenterPoint Energy Resources Corp.	BBB/Negative/—	3
Duquesne Light Co.	BBB/Negative/	4
Duquesne Light Holdings Inc.	BBB/Negative/—	5
TXU Gas Co.	BBB/CW-Dev/—	3
Jersey Central Power & Light Co.	BBB-/Stable/—	4
Metropolitan Edison Co.	BBB-/Stable/—	4
Pennsylvania Electric Co.	BBB-/Stable/—	4
Texas-New Mexico Power Co.	BB+/Stable/—	4
AmeriGas Partners L.P.	BB+/Stable/—	7
NUI Utilities Inc.	BB/CW-Dev/—	4
Suburban Propane Partners L.P.	BB-/Stable/—	8
Star Gas Partners L.P.	BB-/Stable/—	8
SEMCO Energy Inc.	BB-/Negative/—	5
Ferrellgas Partners L.P.	BB-/Negative/—	8
Potomac Edison Co.	B/Stable/—	3
West Penn Power Co.	B/Stable/—	3
Illinova Corp.	B/Negative/—	7
NorthWestern Corp.	D/NM/—	7

## 2. Transmission Only - Electric, Gas, and Other

Questar Pipeline Co.	A+/Negative/—	3
Mid-West Independent Transmission System Operator Inc.	A/Stable/—	1
American Transmission Co.	A/Stable/A-1	1
New England Power Co.	A/Stable/A-1	1
Colonial Pipeline Co.	A/Stable/A-1	3
Dixie Pipeline Co.	—/—/A-1	3
Plantation Pipeline Co.	—/—/A-1	3
Explorer Pipeline Co.	A/Stable/A-1	4
Northern Natural Gas Co.	A-/Positive/—	2
Buckeye Partners L.P.	A-/Stable/—	4
Kern River Gas Transmission Co.	A-/Negative/—	3
Northern Border Pipeline Co.	A-/CW-Neg/—	2
Texas Gas Transmission LLC	BBB+/Stable/—	3
Iroquois Gas Transmission System L.P.	BBB+/Stable/—	3
Florida Gas Transmission Co.	BBB/Stable/—	2
International Transmission Co.	BBB/Stable	2
ITC Holding Corp.	BBB/Stable	2
Texas Eastern Transmission L.P.	BBB/Stable/—	3
PanEnergy Corp.	BBB/Stable/—	3
TE Products Pipeline Co. L.P.	BBB/Stable/—	4
TEPPCO Partners L.P.	BBB/Stable/—	4
Panhandle Eastern Pipeline LLC	BBB/Negative/—	3
Noark Pipeline Finance LLC	BBB/Negative/—	4
Southern Star Central Gas Pipeline Inc.	BB/Stable/—	3
Transwestern Pipeline Co.	BB/CW-Dev/—	4
Transcontinental Gas Pipe Line Corp.	B+/Negative/—	2
Northwest Pipeline Corp.	B+/Negative/—	2
Colorado Interstate Gas Co.	B-/Negative/—	2
Southern Natural Gas Co.	B-/Negative/—	2
ANR Pipeline Co.	B-/Negative/—	3
Tennessee Gas Pipeline Co.	B-/Negative/—	3
El Paso Tennessee Pipeline Co.	B-/Negative/—	3
El Paso Natural Gas Co.	B-/Negative/—	4
Gas Transmission-Northwest Corp.	CC/CW-Pos/—	2

## 3. Integrated Electric, Gas, and Combination Utilities

Wisconsin Public Service Corp.	AA-/Stable/A-1+	4
Madison Gas & Electric Co.	AA/Negative/A-1+	4
Southern Co.	A/Stable/A-1	4
Georgia Power Co.	A/Stable/A-1	4
Alabama Power Co.	A/Stable/A-1	4
Mississippi Power Co.	A/Stable/A-1	4
Gulf Power Co.	A/Stable/—	4
Savannah Electric & Power Co.	A/Stable/—	4
San Diego Gas & Electric Co.	A/Stable/A-1	5
MidAmerican Energy Co.	A/Stable/A-1	5
Questar Corp.	—/—/A-1	6
Equitable Resources Inc.	A/Stable/A-1	6
Florida Power & Light Co.	A/Negative/A-1	4
South Carolina Electric & Gas Co.	A-/Stable/A-2	4
SCANA Corp.	A-/Stable/—	4

Wisconsin Electric Power Co.	A-/Stable/A-2	4
AGL Resources Inc.	A-/Stable/A-2	4
Virginia Electric & Power Co. (Dominion Virginia)	A-/Stable/A-2	5
Idaho Power Co.	A-/Stable/A-2	5
IDACORP Inc.	A-/Stable/A-2	5
Energen Corp.	A-/Stable/-	6
Vectren Utility Holdings Inc.	A-/Negative/A-2	3
Wisconsin Power & Light Co.	A-/Negative/A-2	4
Atmos Energy Corp.	A-/Negative/A-2	4
Southern Indiana Gas & Electric Co.	A-/Negative/-	5
Montana-Dakota Utilities Co.	A-/Negative/-	5
PacifiCorp	A-/Negative/A-2	5
Northern Border Partners L.P.	A-/CW-Neg/-	4
Central Illinois Light Co.	A-/CW-Neg/-	5
CILCORP	A-/CW-Neg/-	5
Union Electric Co.	A-/CW-Neg/A-2	5
Ameren Corp.	A-/CW-Neg/A-2	5
Cincinnati Gas & Electric Co.	BBB+/Stable/A2-	4
Oklahoma Gas & Electric Co.	BBB+/Stable/A-2	4
Northern States Power Wisconsin	BBB+/Stable /A-2	5
Kentucky Utilities Co.	BBB+/Stable/A-2	5
Louisville Gas & Electric Co.	BBB+/Stable/A-2	5
Allete Inc.	BBB+/Stable/A-2	5
Wisconsin Energy Corp.	BBB+/Stable/A-2	5
PSI Energy Inc.	BBB+/Stable/A-2	5
Union Light Heat & Power Co.	BBB+/Stable/-	5
Hawaiian Electric Co. Inc.	BBB+/Stable/A-2	6
Enogex Inc.	BBB+/Stable/-	6
National Fuel Gas Co.	BBB+/Stable/A-2	7
Energy East Corp.	BBB+/Negative/-A2	3
RGS Energy Group Inc.	BBB+/Negative/-	4
Rochester Gas & Electric Corp.	BBB+/Negative/-	4
Michigan Consolidated Gas Co.	BBB+/Negative/A-2	4
Interstate Power & Light Co.	BBB+/Negative/A-2	5
Public Service Co. of New Hampshire	BBB+/Negative/-	5
Kaneb Pipe Line Operating Partnership L.P.	BBB+/Negative/-	5
Consolidated Natural Gas Co.	BBB+/Negative/A-2	6
Detroit Edison Co.	BBB+/Negative/A-2	6
Questar Market Resources Inc.	BBB+/Negative/-	8
Portland General Electric Co.	BBB+/CW-Neg./A-2	5
Columbia Energy Group	BBB/Stable/-	3
NiSource Inc.	BBB/Stable/-	4
Xcel Energy Inc.	BBB/Stable/A-2	5
Public Service Co. of Colorado	BBB/Stable /A-2	5
Northern States Power Co.	BBB/Stable /A-2	5
Southwestern Public Service Co.	BBB/Stable /A-2	5
Appalachian Power Co.	BBB/Stable/-	5
Kentucky Power Co.	BBB/Stable/-	5
Public Service Co. of Oklahoma	BBB/Stable/-	5
Southwestern Electric Power Co.	BBB/Stable/-	5
Northern Indiana Public Service Co.	BBB/Stable/-	5
Entergy Arkansas Inc.	BBB/Stable/-	5

Entergy Louisiana Inc.	BBB/Stable/-	5
Progress Energy Florida	BBB/Stable/-	5
Progress Energy Carolinas Inc.	BBB/Stable/A-2	5
Kansas City Power & Light Co.	BBB/Stable/A-2	6
PNM Resources Inc.	BBB/Stable/-	6
Southern California Edison Co.	BBB/Stable/A-2	6
Empire District Electric Co.	BBB/Stable/A-2	6
Entergy Mississippi Inc.	BBB/Stable/-	6
Entergy New Orleans Inc.	BBB/Stable/-	6
Duke Energy Field Services LLC	BBB/Stable/A-2	6
Arizona Public Service Co.	BBB/Negative/A-2	5
TXU U.S. Holdings Co.	BBB/Negative/-	5
Pinnacle West Capital Corp.	BBB/Negative/A-2	6
Cleco Power LLC	BBB/Negative/A-3	6
Puget Sound Energy Inc.	BBB-/Positive/A-3	5
Puget Energy Inc.	BBB-/Positive/-	5
Green Mountain Power Corp.	BBB-/Stable/-	5
Public Service Co. of New Mexico	BBB-/Stable/A-2	6
Pacific Gas & Electric Co.	BBB-/Stable/-	6
Cleveland Electric Illuminating Co.	BBB-/Stable/-	6
Ohio Edison Co.	BBB-/Stable/-	6
Toledo Edison Co.	BBB-/Stable/-	6
Pennsylvania Power Co.	BBB-/Stable/-	6
El Paso Electric Co.	BBB-/Stable/-	6
Central Vermont Public Service Corp.	BBB-/Stable/-	6
Entergy Gulf States Inc.	BBB-/Stable/-	6
System Energy Resources Inc.	BBB-/Stable/-	7
Tampa Electric Co.	BBB-/Negative/A-3	4
Black Hills Power Inc.	BBB-/Negative/-	6
Westar Energy Inc.	BB+/Positive/-	5
Kansas Gas & Electric Co.	BB+/Positive/-	6
Indianapolis Power & Light Co.	BB+/Stable/-	4
IPALCO Enterprises Inc.	BB+/Stable/-	4
Enterprise Products Operating L.P.	BB+/Stable/-	6
Enterprise Products Partners L.P.	BB+/Stable/-	6
GulfTerra Energy Partners L.P.	BB+/CW-Neg/-	6
Consumers Energy Co.	BB/Negative/-	6
Tucson Electric Power Co.	BB/CW-Neg/-	6
Dayton Power & Light Co.	BB-/CW-Neg/-	7
Monongahela Power Co.	B/Stable/-	5
Nevada Power Co.	B-/Negative/-	7
Sierra Pacific Power Co.	B-/Negative/-	7
Sierra Pacific Resources	B-/Negative/-	7
<b>4. Diversified Energy and Diversified Non-Energy</b>		
WPS Resources Corp.	A/Stable/A-1	5
KeySpan Corp.	A/Negative/A-1	4
FPL Group Inc.	A/Negative/-	6
Peoples Energy Corp.	A-/Stable/A-2	5
Vectren Corp.	A-/Negative/-	4
PacifiCorp Holdings Inc.	A-/Negative/-	5
Exelon Corp.	A-/Negative/A-2	7

MDU Resources Group Inc.	A-/Negative/A-2	7
Centennial Energy Holdings Inc.	A-/Negative/A-2	8
Otter Tail Corp.	A-/Negative/-	8
Kinder Morgan Energy Partners L.P.	BBB+/Stable/A-2	4
Northeast Utilities	BBB+/Stable/-	5
OGE Energy Corp.	BBB+/Stable/A-2	6
LG&E Energy Corp.	BBB+/Stable/-	6
Cinergy Corp.	BBB+/Stable/A-2	6
Constellation Energy Group Inc.	BBB+/Stable/A-2	7
Sempra Energy	BBB+/Stable/A-2	7
Papco Holdings Inc.	BBB+/Negative/A-2	5
Conectiv	BBB+/Negative/-	5
Alliant Energy Corp.	BBB+/Negative/A-2	6
DTE Energy Co.	BBB+/Negative/A-2	6
Dominion Resources Inc.	BBB+/Negative/A-2	7
Kinder Morgan Inc.	BBB/Stable/A-2	5
American Electric Power Co. Inc.	BBB/Stable/A-2	6
Entergy Corp.	BBB/Stable/-	6
Hawaiian Electric Industries Inc.	BBB/Stable/A-2	6
Progress Energy Inc.	BBB/Stable/A-2	6
PPL Corp.	BBB/Stable/-	7
Public Service Enterprise Group Inc.	BBB/Stable/A-2	7
Great Plains Energy Inc.	BBB/Stable/-	7
Duke Energy Corp.	BBB/Stable/A-2	7
Duke Capital Corp.	BBB/Stable/A-2	8
TXU Corp.	BBB/Negative/-	5
Centerpoint Energy Inc.	BBB/Negative/-	5
Cleco Corp.	BBB/Negative/A-3	6
Potomac Capital Investment Corp.	BBB/Negative/-	8
MidAmerican Energy Holdings Co.	BBB-/Positive/-	5
FirstEnergy Corp.	BBB-/Stable/-	6
TECO Energy Inc.	BBB-/Negative/A-3	5
Black Hills Corp.	BBB-/Negative/-	8
Avista Corp.	BB+/Stable/-	6
Edison International	BB+/Stable/-	6
TNP Enterprises	BB+/Stable/-	6
New York Water Service Corp.	BB/Stable	7
CMS Energy Corp.	BB/Negative/-	7
DPL Inc.	BB-/CW-Neg/-	8
Williams Companies Inc. (The)	B+/Negative/-	8
Allegheny Energy Inc.	B/Stable/-	7
Dynegy Inc.	B/Negative/-	8
Dynegy Holdings Inc.	B/Negative/-	9
El Paso CGP Corp.	B-/Negative/-	6
Aquila Inc.	B-/Negative/-	8
El Paso Corp.	B-/Negative/-	8
<b>5. Energy Merchants/Power Developers/Trading and Marketing</b>		
Entergy-Koch L.P.	A/Stable/-	9
KeySpan Generation LLC	A/Negative/-	5
FPL Group Capital	A/Negative/A-1	8
Exelon Generation Co.	A-/Negative/A-2	8



AmerenEnergy Generating Co.	A-/CW-Neg/-	8
Southern Power Co.	BBB+/Stable/-	6
LG&E Capital Corp.	BBB+/Stable/A-2	9
Alliant Energy Resources Inc.	BBB+/Negative/-	9
American Ref-Fuel Co. LLC	BBB/Stable/-	6
PSEG Power LLC	BBB/Stable/-	8
PPL Energy Supply LLC	BBB/Stable/-	8
TXU Energy Co. LLC	BBB/Negative/-	7
Duke Energy Trading and Marketing LLC	BBB-/Negative/-	10
Northeast Generation Company	BB+/Negative/-	9
Cogentrix Energy	BB-/Stable/-	6
PSEG Energy Holdings Inc.	BB-/Stable/-	9
AES Corp.	B+/Stable/-	9
NRG Energy Inc.	B+/Stable	9
Allegheny Energy Supply Co. LLC	B/Stable/-	8
Reliant Resources Inc.	B/Negative/-	8
Calpine Corp	B/Negative/-	9
Edison Mission Energy	B/Negative/-	9
Orion Power Holdings Inc	B/Negative/-	9
Reliant Energy Mid-Atlantic Power Holdings LLC	B/Negative/-	9
Mirant Americas Generation Inc.	D/-/-	10
Mirant Americas Energy Marketing L.P.	D/-/-	10
Mirant Corp.	D/-/-	10
NEGT Energy Trading Holdings Corp	D/-/-	10
PG&E National Energy Group	D/-/-	10
USGen New England Inc.	D/-/-	10

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## **EXHIBIT 5**

**Standard & Poor's  
January 26, 2006**

## RESEARCH

## Research Update: APS, PWCC's 'BBB-' Corporate Credit Ratings Affirmed On ACC Vote But Challenges Continue

Publication date:  
Primary Credit Analyst:

26-Jan-2006  
Anne Selting, San Francisco (1) 415-371-5009;  
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Credit Rating: BBB-/Stable/A-3

### Rationale

Standard & Poor's Ratings Services affirmed its 'BBB-' corporate credit ratings on Arizona Public Service (APS) and its parent, Pinnacle West Capital Corp. (PWCC), following the generally constructive decisions made by the Arizona Corporation Commission (ACC) on Jan. 25. The commission lifted a cap that limited APS' opportunity to recover fuel and purchased power costs and modestly advanced the collection of deferred costs that APS was incurring under the terms of its power supply adjuster (PSA). However, the ACC also restricted APS' ability to file for a surcharge, which raises certain credit concerns. The outlook is stable.

The ACC vote to remove the \$776 million cap on annual fuel and purchased power costs is favorable because it allows APS to defer any costs that exceed this level, which is in fact expected to occur in late 2006. APS' current deferral level is about \$170 million, which will likely increase by approximately \$250 million this year. The ACC adopted an amendment to advance the commencement of recovery of these costs by two months to Feb. 1 from April 1. While the impact is small, providing APS only about \$14 million of incremental recovery in 2006, the vote is an important indicator that the ACC acknowledges that timely action is necessary to limit cash flow pressure on the company. (Note: As a result of staff and company testimony, some of the numbers Standard & Poor's cited in its Jan. 25 credit FAQ have been updated here.)

However, the ACC also voted to prohibit APS from requesting surcharges before the annual PSA adjuster is implemented. Heretofore, Standard & Poor's understood that APS would be permitted to file for surcharge relief any time that deferrals reached \$100 million, as appeared to be implied by the settlement in its last rate case, as amended by the ACC in March 2005. With respect to the \$170 million of deferrals that have accumulated as of year-end 2005, the recently enacted PSA adjuster will generate only about \$111 million over the next 12 months. The remaining \$59 million will be addressed through a surcharge filing, which may be made only after Feb. 1, but for which the collection timeline and approval date are uncertain.

While a technicality, the surcharge vote removes potentially critical flexibility for timely recovery of prudently incurred fuel and purchased power costs. The PSA has a very narrow 4 mill per kilowatt-hour lifetime cap, and the ACC is not bound to act on a surcharge filing by any specific date. As a result, the ACC's decision could cause uncertainty over the timing and disposition of future, expected deferrals.

Standard & Poor's current expectation is that high fuel and purchased power costs will result in a 2006 deferral problem that is larger than that of 2005. The ACC's vote to limit the flexibility of the timing of the surcharge elevates the importance of APS' request for \$299 million in interim emergency rate relief, which is expected to be ruled on in April. That is, a limited PSA with a backstop surcharge that can be filed according to a specified timeline places incremental pressure on other processes that could support credit quality through 2006, especially when permanent rate relief via a general rate case ruling is not expected to occur within the next year.

Much of these issues stem from the very weak PSA, which is triggered

based on a date and not on a threshold level of deferrals and which limits any adjustment to a narrow cap. This structure transfers any deferred balances to a surcharge process. In turn, the surcharge process is open-ended, with no concrete timeline for resolution. At the same time, APS has a significant reliance on natural gas. And this dependence is expected to grow in the coming years. Given the volatility of this fuel and expectations that at least in the near-term prices will remain high relative to historic levels--certainly relative to 2003 levels on which current retail rates are based--a critical underpinning of credit quality is the timing of recovery. This emphasis is particularly important in Arizona, where there is little precedent to support the conclusion that general rate cases can be processed quickly.

However, despite the emphasis that Standard & Poor's places on power supply adjustment mechanisms, it is possible that if the ACC establishes a track record of being supportive and timely toward emergency rate relief requests, that this vehicle could compensate for the current limitations of APS' PSA.

## Outlook

The stable outlook is premised on the ACC providing sustained regulatory support that adequately addresses building deferrals. Negative rating actions could result if regulatory support does not continue, or if market forces or operational issues lead to significant increases in the expected 2006 deferral level.

## Ratings List

Pinnacle West Capital Corp.

Corp credit rating	BBB-/Stable/A-3
Senior unsecured debt	BB+
Commercial paper	A-3

Arizona Public Service Co.

Corp credit rating	BBB-/Stable/A-3
Senior unsecured debt	BBB-
PVNGS II funding Corp Inc.	BBB-
Commercial paper	A-3

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

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## **EXHIBIT 6**

**Standard & Poor's  
January 24, 2006**

<b>STANDARD &amp;POOR'S</b>	<b>RATINGS DIRECT</b>

## RESEARCH

# Credit FAQ: Credit Issues Expected To Continue For Pinnacle West Capital Corp. And Arizona Public Service Co.

Publication date:  
Primary Credit Analyst:

24-Jan-2006  
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On Dec. 21, 2005, Standard & Poor's Ratings Services lowered the corporate credit ratings on Arizona Public Service Co. (APS) and its parent, Pinnacle West Capital Corp. (PWCC) by one notch to 'BBB-'. This action reflected three factors: growing fuel and purchased power deferrals, which are weakening financial performance in 2005 and 2006, the lack of action by the Arizona Corporation Commission (ACC) in 2005 to address a portion of these deferrals through a special surcharge, and the likelihood of delays in the completion of APS' recent general rate case (GRC) filing, which suggest that financial weakening may extend into 2007.

Standard & Poor's stated at the time that any adverse regulatory developments or continued delays in resolving the pending surcharge request could trigger another rating action, which could include a revision of the stable rating outlook to negative, placing the company's debt rating on CreditWatch with negative implications, or lowering the rating to non-investment grade.

## Frequently Asked Questions

### How large are APS' deferrals of fuel and purchased power?

At Jan. 31, 2006, APS' estimated fuel and purchased power deferrals are expected to be about \$165 million. These deferrals are accumulating because APS' base electric rates are set to reflect 2003 costs, and power and natural gas costs have far exceeded these rates. APS collects 2.0473 cents per kilowatt-hour (kWh) in rates for these costs, but for the 12 months ended September 2005, its actual cost averaged 2.701 cents per kWh. Because these rates will not be updated until the completion of APS' recently filed GRC or the emergency interim request, deferrals will likely continue to accumulate in 2006 and into 2007.

The amount by which 2006 actual fuel and purchased power costs will exceed the authorized expenditures will be a function of retail sales growth, commodity costs, the operational performance of APS' generation assets, and the fuel-in-base factor. Standard & Poor's has estimated that, at year-end 2006, the utility will likely incur an additional \$250 million in fuel and purchased power costs that are not recoverable in base electric rates. The sum of balances to date of \$165 million plus the expected incremental deferrals of \$250 million total \$415 million; however, because APS has the potential to collect some of its 2005 balances through a power supply adjuster (PSA) beginning April 1, year-end 2006 deferrals on the utility's balance sheet will not reach that level.

### What are the ways that APS could recover its expected deferrals?

Under the terms of a settlement reached in APS' 2003 rate case approved by the ACC in April 2005, the PSA may be increased as much as four mills per kWh (a cap over the life of the PSA) on April 1, 2006. Using 2005 retail sales, and assuming a 4.5% growth rate (which is consistent with recent results), the four mills should yield about \$125 million in rate relief on an annualized basis, or about \$83 million for the eight months of 2006. Thus, as a rough approximation, APS' deferred balance would be about \$330 million at year-end 2006.

On Jan. 17, the chairman of the ACC introduced a proposal to accelerate the PSA adjustment to Feb. 1. If this were approved by the ACC, an additional two months of the PSA would provide about \$20 million in incremental revenues (e.g., roughly \$125 million multiplied by two-twelfths of the year) in 2006. Thus, if the Hatch-Miller amendment moves forward, year-end 2006 deferred balances will be closer to about \$310 million. The amendment is expected to be discussed on Jan. 24.

Additional relief could be provided if the ACC grants APS' request to recover \$80 million by means of a two-year special surcharge that would increase retail rates by about 2%. On Jan. 4, an administrative law

APS06982

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judge issued a decision indicating that APS' surcharge application is premature until the company's first power supply adjustment occurs in April. An ACC vote is scheduled for Jan. 24. Standard & Poor's current assumption is that the surcharge will be approved by the ACC, but will be delayed until July 1, 2006. A surcharge implemented at this time would provide roughly an additional \$20 million to the company in 2006. If it were implemented sooner, the impact on deferrals would be relatively small, providing about \$3 million in each month it is in place during 2006. If the Hatch-Miller amendment were approved and a surcharge was implemented and approved for Feb. 1, the two measures collectively would bring between \$50 million-\$57 million in relief. Accordingly, relative to the year-end expected balances, an accelerated surcharge and PSA, if granted, will reduce deferrals but only by about 20% in the best-case scenario.

**What is the status with APS' emergency interim filing?**

On Jan. 6, 2006, APS filed a \$299 million request for emergency fuel and purchased power-related rate relief. Any amounts, if granted, would be subject to future prudency review. As part of a procedural conference on Jan. 12, four of the five commissioners questioned the definition an emergency and whether relief is justified. Based on the strong views expressed, it appears unlikely that the filing has support. On Jan. 19, a procedural schedule was set that should allow for a decision in April 2006. Standard & Poor's forecast estimates do not assume emergency relief is granted.

**Are there credit concerns related to APS' rate cap?**

Balancing these potential sources of rate relief are additional adverse financial effects that could occur for APS if its "hard cap" of \$776 million is not lifted. The cap is part of APS' 2004 settlement, approved by the ACC in April 2005, which restricts the total amount of annual fuel and purchased power costs that can be collected in retail rates. APS expects that its fuel and purchased power costs will exceed the cap in the fourth quarter of 2006, and has indicated publicly that its estimated fuel costs will exceed \$800 million. As part of its emergency interim filing, APS has requested that the cap be removed. If the cap is not lifted, any amounts above \$776 million would be unrecoverable, putting further pressure on cash flows.

**What assumptions does Standard & Poor's make about the performance of APS' generation assets in estimating deferred balances?**

Standard & Poor's estimates assume normal operational performance of APS' generation fleet. Forced outages could increase deferred balances. Palo Verde unit 1 is in the process of exiting an outage that occurred last week due to pipe vibrations within the emergency cooling system. APS took the unit offline last week to install clamps in an effort to stop the excess vibrations. From late December until Jan. 17, unit 1 has operated at about 30% capacity while crews have tried to fix the problem, which followed the completion of the unit's exit from a refueling and maintenance outage begun in the fall of 2005. The plant is expected to maintain approximately this level of reduced capacity while additional repairs are considered. Replacement power costs have been incurred in association with this last outage, and could build, depending on the timeline for a solution to be implemented. These and any future costs are not part of Standard & Poor's deferred estimates.

**How are these estimated deferrals expected to affect 2005 and 2006 financial performance, especially in the context of the credit benchmarks at the 'BBB-' rating?**

Year-end results for 2005 are not yet available, but Standard & Poor's expects that 2005 and 2006 results will be on par with the 12 months ending Sept. 30, 2005, when consolidated adjusted funds from operations (FFO) to total debt was 14.8%. FFO to total debt is an important metric for Standard & Poor's, and at a business profile of '6' (on a 10-point scale where '1' is excellent and '10' vulnerable), it reflects a below-investment-grade performance. For the 12 months ending Sept. 30, 2005, FFO interest coverage was 3.3x, which is reasonable for the current rating. Adjusted total debt to total capitalization was 53.1%, and is solid for the current rating.

Performance in 2007 will be heavily dependent on when the GRC is resolved. APS filed on Nov. 4, 2005, for a \$409.1 million (or 19.9%) rate increase, the majority of which is related to fuel and purchased power costs. Typically, the ACC certifies the application as complete within 30 days, and the case commences. But in early December 2005, the ACC requested that the company re-file its application using a test year ending Sept. 30, 2005, rather than the Dec. 31, 2004 data that APS used. The updated application is expected to be re-submitted to the ACC on Jan. 31, 2006.

As a result, the case will not begin until early March 2006, suggesting that an outcome will be delayed roughly three months from the original schedule, which envisions a ruling by early 2007. Recent public statements by the ACC indicate that spring 2007 may be the earliest a decision could be expected. But there is little precedent in Arizona that would suggest a year-long rate case is likely. A more conservative estimate would assume mid-2007. This could be a credit concern because if permanent rate relief is not in place prior to the peak summer season, financial recovery could also be stalled in 2007.

**How is the company's liquidity?**

Unaudited consolidated cash and investments stood at roughly \$150 million as of Dec. 31, 2005. PWCC

and APS also maintain a total of \$700 million in revolving credit facilities, which had approximately \$15 million of usage at year-end 2005 for miscellaneous letters of credit. Standard & Poor's preliminary assessment is that the company's credit lines should be sufficient to support working capital needs, purchases of gas and power, as well as fund margining and collateral requirements for trading operations. As of Dec. 31, 2005, PWCC and APS comfortably met their loan covenant requirements.

PWCC has a \$300 million dollar maturity on April 1, which it plans to refinance. Adverse regulatory actions could affect the costs of borrowing or even access to the capital markets, although this is not currently seen as a significant threat.

APS' reliance on purchases and gas-fired peaking capacity during the winter is low; however, this is seasonal. Fuel and purchased power expenses are anticipated to be accrued faster in July 2006 through September 2006. Standard & Poor's is conducting a more detailed liquidity assessment, which will be completed once more clarity is provided on how the ACC is expected to address interim rate relief requests. APS has a significant hedging program and 85% of its 2006 power and gas requirements are hedged. APS and PWCC are currently holding counterparties' collateral as a result of their in-the-money hedged positions.

**Could cost saving measures, or the sale of nonregulated assets by PWCC assist in restoring credit quality?**

The ACC has requested that the company explain what cost reductions it is making to compensate for the fact that its retail rates are not aligned with production costs. In response, the company cancelled bonuses for its corporate officers, and is certain to investigate additional cost-savings measures. While these actions may address other public policy issues of concern to the ACC, from a credit standpoint cost cutting measures are unlikely to materially alleviate APS' sagging financial performance.

The deferred balances stem from fuel and purchased power costs that the utility incurred to serve retail loads. APS earns no margin on these expenses; they are simply passed straight through to customers. Similar to the circumstances that other western utilities have faced in recent years, APS' fuel and purchased costs substantially exceed the amount currently recoverable in rates. The company may be able to temporarily subsidize the cost of serving retail loads by reducing expenses in other parts of the company, selling other PWCC assets, or issuing debt, but such a strategy is not sustainable, and could very well result in longer-term adverse consequences for the company.

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# **EXHIBIT 7**

**FITCH**  
**January 30, 2006**

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## **Fitch Lowers PNW & APS' Sr. Unsecured Ratings to 'BBB-' & 'BBB', Respectively; Outlook Stable**

**Ratings**

30 Jan 2006 4:23 PM (EST)

Fitch Ratings-New York-30 January 2006: Fitch Ratings has lowered Pinnacle West Capital's (PNW) long- and short-term ratings. At the same time, Fitch has lowered Arizona Public Service Company's (APS) long-term ratings, while affirming its commercial paper rating. The securities of PNW and APS have been removed from Rating Watch Negative, where they were placed Jan. 6, 2006. The Rating Outlook is Stable. The following actions are effective immediately:

### **Pinnacle West Capital:**

- Issuer default rating (IDR) downgraded to 'BBB-' from 'BBB';
- Senior unsecured debt downgraded to 'BBB-' from 'BBB';
- Commercial Paper downgraded to 'F3' from 'F2'.

The Rating Outlook is Stable.

### **Arizona Public Service Co.**

- IDR downgraded to 'BBB-' from 'BBB';
- Senior unsecured debt downgraded to 'BBB' from 'BBB+';
- Commercial Paper affirmed at 'F2'.

The Rating Outlook is Stable.

Approximately \$3.8 billion of debt is affected by the rating actions.

The rating actions and Stable Rating Outlook reflect the resolution of APS' power supply adjustor (PSA) proceedings by the Arizona Corporation Commission (ACC) and the utility's significant exposure to high and rising natural gas commodity costs. The commodity exposure is a function of a generating capacity mix, about half of which is natural gas fired, and rapid service territory load growth, which is likely to be met predominantly by natural gas-fired resources. The revised ratings also consider the operational risk and asset concentration of the Palo Verde nuclear plant. The facility has experienced intermittent operating problems over the past year and a sustained, unscheduled outage at the plant could lead to further negative rating actions.

The ACC decision in the PSA proceedings, issued on Jan. 25, 2006, has positive and negative implications for PNW and APS' creditworthiness. The commission's decision to accelerate the effective date of the PSA rate to Feb. 1 from April 1, along with the removal of the \$776 million annual power supply cost limit, were constructive developments in Fitch's view. However, the ACC bench order rejecting APS's \$80 million surcharge request on procedural grounds and restriction of PSA adjustments to an annual reset is less favorable than Fitch had anticipated in its previous ratings and is a significant source of concern for PNW and APS fixed-income investors. The fact that there is no vehicle within the PSA protocol to recover supply costs more frequently than annually during periods of sustained high and rising energy costs subjects APS to significant cash flow volatility and working capital requirements. Such costs would be exacerbated in a meaningful way by an extended outage of a base load nuclear- or coal-fired generating facility during periods of peak demand. The only option to recover fuel and purchase power costs above amounts determined annually in the PSA would be an emergency rate filing, in which the timing and amount of rate relief would be uncertain.

It is Fitch's understanding that energy cost deferrals in a particular year of up to four mills per kilowatt hour (approximately \$110 million-\$115 million on an annual run rate) will be recovered through an annual PSA rate adjustment that will recover those costs over the following 12 months. The surcharge is expected to facilitate recovery of costs in excess of the four mills per kilowatt hour limit over a time horizon to be determined by the commission.

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